FILE COPY

Office - Supreme Court
FILED
OCT 1 193
CHARLES ELMORE CR
CL

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 354

IN THE MATTER

of

UNITED CIGAR STORES COMPANY OF AMERICA,

Debtor,

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as trustees,

Petitioners,

against

IRVING TRUST COMPANY, Trustee, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION ON BEHALF OF TRUSTEE

WILLIAM D. WHITNEY,
Counsel for Respondent,
Irving Trust Company, as Trustee.

DONALD C. SWATLAND,
R. L. GILPATRIC,
Of Counsel.

TABLE OF CONTENTS

	PAGE
OPINIONS BELOW	1
THE FACTS	2
QUESTIONS SOUGHT TO BE RAISED	3
STATUTE INVOLVED	3
SUMMARY OF ARGUMENT IN OPPOSITION TO WRIT	4
ARGUMENT	
POINT I—The constitutionality of the provision in Section 77B limiting landlords' claims is not raised by the application of the limitation to the petitioners' claim	5
POINT II—The decision of the Circuit Court of Appeals upholding the constitutionality of Section 77B (b) (10) as applied to the petitioners' claim presents no questions requiring a review by this Court	7
(a) The decision below is in accord with established principles and the applicable decisions of this Court	7
(b) No conflict exists among the several Circuit Courts of Appeals	10
CONCLUSION	10
APPENDIX	11

TABLE OF CASES CITED

	PAGE
Calhoun v. *Massie*, 253 U. S. 170	7
Campbell v. *Alleghany Corporation*, 75 F. 2d 947, 951, cert. den. 296 U. S. 581	10
Continental Illinois National Bank & Trust Co. v. *Chicago, Rock Island & Pac. Ry. Co.*, 294 U. S. 648, 671	8
Hanover National Bank v. *Moyses*, 186 U. S. 181, 186	8
Irving Trust Co. v. *Perry Co.*, 293 U. S. 307	6
Kothe v. *R. C. Taylor Trust*, 280 U. S. 224, 227	7
Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555, 587	8
Manhattan Properties, Inc. v. *Irving Trust Co.*, 291 U. S. 320, 338	5, 7, 9
Massachusetts v. *Mellon*, 262 U. S. 447, 488	5
Miller v. *Irving Trust Co.*, 296 U. S. 256, 258	6
Norman v. *Baltimore & Ohio R. Co.*, 294 U. S. 240	7
Shepherd v. *Mt. Vernon Trust Co.*, 269 N. Y. 234	7

AUTHORITIES CITED

Gerdes on Corporate Reorganization (ed. 1936), Vol. I, § 34, p. 130	10
Extract from House Report 1821, 73d Congress, 2d Session, with respect to H. R. 5884	11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 354.

IN THE MATTER

of

UNITED CIGAR STORES COMPANY OF AMERICA,

Debtor,

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as trustees,

Petitioners,

against

IRVING TRUST COMPANY, Trustee, *et al.*,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION ON BEHALF OF TRUSTEE

OPINIONS BELOW

The opinion of the Special Master (Irwin Kurtz, Referee in Bankruptcy) appears on page 79 of the record and

is not reported. The opinion of the District Court (per Judge Knox) is found in the record at page 146 and is not reported. The opinion of the Circuit Court of Appeals (per Judge L. Hand) appears on page 150 of the record and has not yet been reported.

THE FACTS

In 1926 the petitioners' predecessors made a lease to the Debtor of property in the City of Trenton, New Jersey, for a term to expire on March 31, 1946 (R. 30, 46). The Debtor was adjudicated bankrupt on August 29, 1932, and its trustee in bankruptcy rejected the lease and surrendered the premises on November 14, 1932 (R. 5). Thereupon, the petitioners re-entered, terminated the lease and re-let[1] in pursuance of a clause in their lease by which the Debtor had covenanted that in such event it would

> "* * * indemnify the Landlords against all loss of rents which the Landlords may incur by reason of such termination, during the residue of the term above specified" (R. 58).

After Section 77B had been enacted and proceedings for reorganization of the Debtor begun, the petitioners filed a claim for the entire rent payable under their lease until its expiration in 1946, less the alleged fair rental value for the same period (R. 4-11). The Trustee conceded the allowability of a claim on the indemnity covenant, but moved to reduce it to an amount limited to the maximum of three years' rent plus accruals, as provided in the

---

[1]Two-thirds of the premises were re-let until 1938 (part on a percentage basis) with the balance being occupied under monthly tenancies (R. 62, 70, 41).

statute (R. 15). The Trustee's position was sustained successively by the District Court and the Circuit Court of Appeals, and the claim allowed on such limited basis, *i. e.*, for $44,377.55 (R. 118).

QUESTIONS SOUGHT TO BE RAISED

This Court is asked to pass upon the construction and constitutionality of an act of Congress [Section 77B(b)(10)] which amended the Bankruptcy Act of 1898 to provide for the provability, to a limited extent, of landlords' claims for future rent in proceedings for reorganization of corporations. The questions are presented in respect of a lease containing an indemnity covenant, under which a claim has been allowed pursuant to such statutory provision but limited to a maximum of three years' rent as provided in the statute. The petitioners urge, *first*, that the statutory provision should not be construed as limiting their claim as against the interest of the Debtor's stockholders and, *second*, that if so construed the limitation provision is unconstitutional.

STATUTE INVOLVED

The provision of Section 77B (b) (10) of the Bankruptcy Act which is involved in this case reads as follows:

> "*The claim of a landlord* for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this act, but *shall be limited*

to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: * * *." [Italics ours.]

SUMMARY OF ARGUMENT IN OPPOSITION TO WRIT

(1) On the question of statutory construction we have nothing to add to the opinion of the Circuit Court of Appeals (R. 151). We refer this Court in addition only to the final conference report on the bill (H. R. 5884) subsequently enacted as Section 77B, an extract from which is set forth in an Appendix to this brief.

(2) As to the supposed unconstitutionality of the statute, the Trustee urges that a writ be denied to the petitioners for two reasons:

(a) The power of this Court to hold an act of Congress unconstitutional cannot properly be invoked in this case because the petitioners have not sustained, nor are they in immediate danger of sustaining, any direct injury as a result of the statute complained of.

(b) The decision below is manifestly correct, is in harmony with the applicable decisions of this Court and is not in conflict with the views expressed by any other circuit court of appeals.

ARGUMENT

POINT I.

THE CONSTITUTIONALITY OF THE PROVISION IN SECTION 77B LIMITING LANDLORDS' CLAIMS IS NOT RAISED BY THE APPLICATION OF THE LIMITATION TO THE PETITIONERS' CLAIM.

This Court has made it abundantly clear that its power to disregard Congressional enactments as unconstitutional will be sparingly exercised. *Massachusetts* v. *Mellon,* 262 U. S. 447, 488:

> "The party who invokes the power [to disregard an unconstitutional enactment] must be able to show not only that the statute is invalid but that he has sustained or is immediately in danger of sustaining some direct injury as a result of its enforcement, and not merely that he suffers in some indefinite way in common with people generally."

The claim here presented is based upon a covenant by the Debtor to indemnify the petitioners against loss of rent under their lease during the residue of the term ending in 1946. Such a covenant, this Court has twice held, does not give rise to a complete obligation until the expiration of the term, in this instance ten years hence, when the actual loss, for which the indemnity is provided, may be ascertained.[2] (*Manhattan Properties, Inc.* v. *Irving Trust Co.,*

---

[2]If rental values in the City of Trenton have appreciated by 1938 when the present re-letting arrangements run out, the petitioners may be able to obtain high enough rentals over the eight-year balance of the term to recoup their earlier losses. The property is unquestionably in a position to benefit from any improvement in real estate conditions (R. 31, 35).

291 U. S. 320, 338; *Miller* v. *Irving Trust Co.*, 296 U. S. 256, 258). In both cases cited, this Court flatly rejected the landlord's contention that an indemnity covenant of the type found in the petitioners' lease is the equivalent of an agreement by the tenant to pay liquidated damages in the event of bankruptcy.

Had the petitioners' lease contained a liquidated damages clause of the type held to give rise to a provable claim prior to Section 77B (*cf. Irving Trust Co.* v. *Perry Co.*, 293 U. S. 307), and had petitioners' damages under such clause exceeded the limit put by the statute upon landlords' claims, the petitioners might be in a position to raise the constitutional issue.[3] But such is not the present case, as the Court below recognized (R. 156).

The Court below, once having determined that a claim on the indemnity covenant was provable, did rule, to be sure, that the claim was "to be liquidated by discounting the future payments and subtracting the appraised value of the term from their sum" (R. 151). Whether that rule of damages was properly applied is not now at issue as this Court has not been requested to review the allowance of the claim in the amount of the statutory maximum. But in so ruling and in accepting what it recognized to be "speculative evidence of damages" (R. 153) the Court's interpretation of the statute as providing for the present liquidation of a future right was conditioned upon the effectiveness of the limitation. The petitioners have accepted the benefit of the statutory scheme of liquidation in the allowance of their claim for the statutory maximum upon an equality

[3]No claims have been filed by landlords of United Cigar Stores Company of America which raise any question of the applicability of the statutory limitation in cases where the leases contain liquidated damage clauses.

with other claims with which they were not entitled to share prior to Section 77B. They cannot look to the statute for the benefit and repudiate the limitation (*Calhoun* v. *Massie*, 253 U. S. 170; *Shepherd* v. *Mt. Vernon Trust Co.*, 269 N. Y. 234).

POINT II.

THE DECISION OF THE CIRCUIT COURT OF APPEALS UPHOLDING THE CONSTITUTIONALITY OF SECTION 77B (b) (10) AS APPLIED TO THE PETITIONERS' CLAIM PRESENTS NO QUESTIONS REQUIRING A REVIEW BY THIS COURT.

(a) The decision below is in accord with established principles and the applicable decisions of this Court.

In deciding that the provision in Section 77B limiting the petitioners' claim to three-years' rental was valid, the Court below necessarily considered, *first*, whether the statute falls within one of the congressional powers, and *second*, whether it represents a reasonable exercise of that power (*Norman* v. *Baltimore & Ohio R. Co.*, 294 U. S. 240).

(1) It is settled that it is within the scope of the bankruptcy power for Congress to provide for an *equitable distribution* of the assets of the estate (*Kothe* v. *R. C. Taylor Trust*, 280 U. S. 224, 227). Indeed, this Court has said, referring to the allowability of future rent claims under the Bankruptcy Act prior to its amendment in 1934:

> "The issue is not one of power, for plainly Congress may permit such claims or exclude them." (*Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 332.)

The fact, so stressed in the petition herein, that the bankruptcy power has not heretofore been exercised to limit claims of a certain class of creditors does not detract from the existence of the power. (See *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 587):

> "But, the scope of the bankruptcy power conferred upon Congress is not necessarily limited to that which has been exercised".

Indeed, since the Constitution was adopted, there have been many extensions of the bankruptcy power which, although "fundamental and radically progressive" in nature, have been "judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution" (*Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pac. Ry. Co.*, 294 U. S. 648, 671).

Nothing said by this Court in the *Radford* case requires a conclusion different from that reached by the Court below. In the *Radford* case, while holding that as against the Fifth Amendment Congress could not under the bankruptcy power take away a vested right in specific real estate (in that case mortgage rights), this Court was careful to point out that a contrary rule applied where only a personal obligation was concerned. In such a case Congress, being free of constitutional inhibition upon the impairment of contracts (*cf. Hanover National Bank* v. *Moyses*, 186 U. S. 181, 186), has the power to limit or discharge personal obligations (See 295 U. S., at p. 589).

(2) There remains the question whether the particular limitation prescribed by Congress for landlords' claims is arbitrary or capricious, or whether it furnishes an appropriate means to the legitimate end of providing for equitable distribution under the Bankruptcy Act.

This Court had held that landlords' claims were not provable under the Bankruptcy Act prior to its amendment in 1934 (*Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320). When Congress set out, therefore, to make equitable disposition of landlords' claims under Section 77B, its problem was to concede something to a class which had nothing before. But in determining upon the treatment to be accorded to landlords, Congress could not fail to take into account the inherently speculative and contingent character of claims for loss of future rents, as recognized by the long line of federal cases culminating in the *Manhattan Properties* decision.

Congress might have adopted the equity rule barring contingent claims beyond deficiencies accruing to the end of the period for filing claims. The alternative was to treat landlords' claims as allowable where the debtor remained liable under a covenant for damages or indemnity and where there was present evidence of some loss. This, the Court below has held, is what Congress had in mind in order to avoid leaving an indeterminate amount of contingent claims to be dealt with in the plan of reorganization. Then, to spare the courts the necessity of speculating as to the precise amount of loss which might ultimately be sustained by landlords with long term leases, Congress put a top limit on all such claims.

The reasonableness of the statutory limitation as applied to the petitioners' claim can scarcely be questioned. It is one thing to grant, as was done here, that based on the most reliable evidence presently available, the petitioners' loss over the term would not be less than $45,377.55, the maximum amount allowable under the statute. But it is something else for a court now to be required to find *as a fact*

that by March 31, 1946, the claimants' loss will be $87,692.30 (the alleged differential between the rent reserved and the rental value as now estimated), or, indeed, that it will even equal $45,377.55.

(b) No conflict exists among the several Circuit Courts of Appeals.

The unanimous decision of the three Circuit Judges sitting below is the only express holding to date with regard to the limitation of landlords' claims provided in Section 77B. Thus no conflict has arisen among the several circuit courts of appeals to move this Court to grant a review. Indeed, the constitutionality of the limitation seems to have been assumed by the Circuit Court of Appeals for the Fourth Circuit in *Campbell* v. *Alleghany Corporation*, 75 F. 2d 947, 951, cert. den. 296 U. S. 581. Moreover, the only text-writer who has dealt with the subject agrees that the treatment of landlords' claims in Section 77B "is reasonably calculated to deal with the problem" (*Gerdes on Corporate Reorganization* (ed. 1936), Vol. I, § 34, p. 130).

CONCLUSION

The petition for a writ of certiorari should, for the reasons stated above, be dismissed, with costs.

WILLIAM D. WHITNEY,
Counsel for Respondent,
Irving Trust Company, as Trustee.

DONALD C. SWATLAND,
R. L. GILPATRIC,
Of Counsel.

APPENDIX

Extract from House Report 1821, 73d Congress, 2d Session, with respect H. R. 5884:

"Amendment No. 14: Under the House bill, executory contracts, including claims for future rent, are made provable claims for the purposes of this section. The Senate Amendment limited claims for future rent to an amount equal to the rent reserved by the lease for 1 year.

The amendment agreed to by conference makes any person injured by the rejection of an executory contract or unexpired lease of real estate a creditor for the purposes of this section. The claim of the landlord for injury resulting from loss of future rents is limited to an amount not to exceed the rent reserved by the lease for 3 years next succeeding the date of surrender of the premises or the date of re-entry of the landlord, whichever first occurs, plus unpaid rent accrued up to such date of surrender or re-entry of the landlord. * * *"